

C O N F I D E N T I A L SECTION 01 OF 04 ANKARA 001007

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STATE FOR E, P, EB AND EUR/SE
NSC FOR EDSON, FRIED, AND QUANRUD
TREASURY FOR U/S TAYLOR AND OASIA - LOEVINGER/MILLS
STATE PASS USTR - NOVELLI AND MOWERY

E.O. 12958: DECL: 09/02/2010
TAGS: EFIN PREL FAID ETRD TU
SUBJECT: U/S TAYLOR'S TALKS ON THE GRANT/LOAN FACILITY,
FEBRUARY 6-7 IN ANKARA

REF: A. ANKARA 1003
B. ANKARA 861

Classified by Ambassador Robert Pearson for reasons 1.5
(b,d).

Summary

¶1. (C) On February 6-7, Treasury U/S Taylor and his delegation met with a GOT delegation, led by Minister of State in charge of Treasury Ali Babacan, which included Treasury, Central Bank, and State Planning officials, and Babacan's academic economist advisor. Minister of Finance Kemal Unakitan also participated in the talks, and Taylor had a separate meeting on the trade package with State Minister for Foreign Trade Kursad Tuzmen.

-- Agreement was reached on the term sheet for the loan/grant facility, with the exception of six brackets. The main bracketed issue concerns economic reform conditionality: the Turks agree to completion of the Fourth Review with the IMF as a condition precedent, but otherwise want no reference to IFI programs in the conditions, and at least some part of the GOT team (MinFin Unakitan) wants no conditions on the grant portion.

-- The Turks raised four other issues outside the term sheet: an economic MOU to complement the military and political MOUs; a contingency portion of the facility in case Turkey's economy is worse than expected; a bridge or other short-term loan before Congressional approval; and a list of trade and Iraq-related concessions that goes well beyond our trade package. Taylor dispensed with the contingency portion (impossible) and the trade list (we already gave a generous package), and said we'd get back on the other two, but the Turks may be expected to raise all four again.

-- The Turks agreed to defer the magnitude issue while we finalized the terms, but again raised it at the end of Taylor's visit, asking for \$92 billion.

¶2. (C) Embassy would like instructions for use by the Ambassador on the Economic MOU by our COB February 10, and for the U.S. del to plan to return to Ankara by February 12, with a view to finalizing our package before the February 18 parliamentary vote. See action request at para. 18.

Magnitude of the Facility

¶3. (C) Babacan stressed, in opening remarks 2/6 and 2/7, the Turkish main concern with the amount or magnitude of our package. He referred several times to the GOT charts claiming GNP losses from the 1991 Gulf War, and estimating GNP losses from a new conflict in Iraq at over \$100 billion.

¶4. (C) Taylor responded that there's enormous variation in GNP forecasts (Turkey's own forecast for 2002 GNP growth was 3 percent, but it ended up close to 7 percent), that GNP losses cannot be attributed solely to one factor like the Iraq conflict, that Turkish estimates didn't catch the enormous positives of a free Iraq, and that our package was designed to contain GNP effects by affecting Turkish real interest rates and the exchange rate. He stressed that our package was huge - as much as 10 percent of Turkey's GNP given the loan options. The Ambassador and Taylor asked

Babacan to set aside the discussion of the numbers, and urged the Turks to reach agreement on all other issues related to the economic assistance package in these discussions. Babacan agreed.

15. (C) The magnitude issue came up at the end of the talks, in a one-on-one discussion late 2/7 with Babacan and MinFinance Unakitan, which followed Taylor's meetings with PM Gul and MFA U/S Ziyal. Babacan and Unakitan told Taylor their number for the bilateral support package should be \$92 billion. Taylor responded that that number was unacceptable.

Turkish Request for Comprehensive MOU
On Economic Assistance

16. (C) In the initial session 2/6, Taylor tabled the draft term sheet, and the Turks agreed to provide comments on it. On 2/7, the Turks also tabled a document, a "Memorandum of Understanding for Economic Assistance Program between the Republic of Turkey acting by and through (the Undersecretariat of Treasury) and the United States of America acting by and through (blank)." Babacan said the GOT wanted three MOUs - for the political, military, and economic aspects - and the economic MOU should include all the agreements and understandings related to economic assistance, including "bridge financing," the grant/loan facility, oil support, and "immediate and medium term economic cooperation and support" which could include trade concessions and procurement commitments. (Embassy faxed the draft MOU to EUR/SE on 2/8.)

17. (C) Taylor said he could not agree to the concept of an economic MOU without instructions from Washington. His instructions were to reach agreement on the terms of the grant/loan facility. He strongly doubted that some elements of the draft MOU - oil support for instance - could be put in writing. Conferring with the Ambassador, he asked the Turks to defer discussion of the MOU as a format issue, and instead to focus on the substance of the terms in our term sheet. The substance of these terms could be incorporated in whatever documents we later decide to sign. Babacan agreed, noting that a major part of the MOU concerned the grant/loan facility.

Turkish Requests for a Additional Contingency
Portion of the Facility, and for a Bridge Loan

18. (C) Contingency Portion. Babacan, referring to the GOT's draft MOU, said an important element of the grant/loan facility to the Turks was "adaptability." He explained this to mean a USG commitment now to seek an additional support package, if the military operation takes longer or if other things occur which increase the damage to Turkey from the operation. Taylor replied that we could not build in such a contingency. This was not the way our or other legislatures worked. Our facility preserves flexibility in the loan terms, and Taylor stressed this was an unprecedented arrangement for the USG. The loan terms (interest rate, maturity) were flexible to allow us to respond to changing circumstances, but the budget cost amount we are seeking from Congress could not be re-opened, and he stated that legislatively this was impossible.

19. (C) Bridge Loan. Both Babacan and Treasury Under Secretary Oztrak stressed the need for a short-term "bridge

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loan" component of our assistance. They noted GOT vulnerability in March to debt roll-over concerns (on both March 5 and 19 there is a \$2.5 billion debt payment to the markets, ref b). They doubted that the USG announcement of intention to seek a support package for Turkey would be sufficient to calm market concerns in March. Taylor explained that we can only bridge to something concrete and very short-term, citing the five-day bridge loan to Uruguay. If Turkey were in position to complete its IMF Fourth Review, and a board date were established, perhaps we could bridge to it. Babacan replied that if "bridge financing" were impossible, the USG should consider some other form of short-term financing, prior to Congressional approval of the grant/loan facility, stating that this was a "critical" need.

110. (C) Taylor reiterated that he saw no way for the USG to do this, but agreed to take the matter back to Washington.

He stressed that he wanted Babacan and the GOT to understand the trade-offs involved. We had just put together a very generous trade package for Turkey which had been very difficult to do, but was considered insufficient by the Turkish side (see below). There were trade-offs involved in every new request, he cautioned.

Term Sheet Issues - Economic Reform Conditionality

¶11. (C) Most of the full day talks on 2/7 focused on the draft term sheet, and agreement was reached on all terms with the exception of six brackets (ref a). Taylor stressed that the term sheet was an informal document, and that final terms would be spelt out in a different document, such as a loan agreement, but would incorporate terms we agreed on now. Turkish remaining concerns are as follows:

¶12. (C) Economic reform conditionality. Babacan agreed that completion of the Fourth Review with the IMF was a condition precedent, but otherwise wanted to "keep separate" the USG facility and the IMF/World Bank programs, both in the condition precedent and cause for termination terms. He also questioned the "subjectivity" of this condition, saying "who will judge whether our policies are strong enough?" Separately, MinFinance Unakitan said he agreed with economic reform conditionality on loans, but not on grants. Grants were a gesture of friendship, he stressed, and they should be unconditional. Asked if this was the GOT position, Babacan agreed that grants should be unconditional, and conditionality on loans should more generally refer to "strong economic policies" without reference to the IFIs.

-- Taylor responded that economic reform conditionality is needed for market confidence. Since Turkey is committed to an IMF-backed reform program, it's needed here to give markets assurance that this program will be fully implemented. Cutting references to the IFI-supported programs would be harmful. Taylor stressed that the reference to "strong economic policies" allows for adjustments in circumstances. Furthermore, responding to Unakitan, he said that both grants and concessional loans are gestures of friendship. (Unakitan nodded.) Taylor said to achieve the purpose of the Facility - to contain the economic impact from a conflict in Iraq - required two elements working together. "We're doing the grant/loan facility, and you're doing your part, the good policies."

¶13. (C) Other concerns. Babacan didn't want "full military cooperation" either as a condition precedent or a cause for termination, stating that this issue would be solved shortly by signing of the military MOU. We agreed to keep the term in, but to bracket language "to be defined." The remaining brackets were requested by the Turks for the default and penalty terms. Babacan said he didn't want to contemplate what the situation Turkey would be in if these terms became operable. Oztrak wanted to check if our language was consistent with Turkey's World Bank loans. (Treasury DG Ekren produced such loan documents and they looked substantially the same as our language.) Taylor said legal documents such as loan agreements needed to contemplate such eventualities, though no one wanted them; he also noted this language was used in USAID loans and required by us.

-- General tone of the language. On 2/7 morning, Babacan said having read the term sheet overnight, that it sounded like terms given by the IMF to Argentina, not the provision of a loan or grant facility to an ally. He asked that the language reflect to the extent possible the context of two allies countries going to war against a joint enemy, though he offered no specifics.

Trade Package

¶14. (C) After Taylor's meeting with PM Gul (septel), Babacan set up an evening meeting for the U.S. del with State Minister for Foreign Trade Kursad Tuzmen. Babacan said the GOT's proposals on trade would be part of the Economic MOU (in Article VI on "Immediate Support Mechanism") and Tuzmen had contributed to this list of proposals. (He later explained that the list, faxed to EUR/SE, included both Tuzmen proposals, printed in bold, and Treasury and MFA proposals, in non-bold type face.)

¶15. (C) Tuzmen devoted his time with Taylor to a long-winded justification of his focus on expanding Turkey's trade with

its neighbors, which is at present only 5 percent of Turkey's foreign trade. "And why only 5 percent? Because our neighbors are either enemies or potential enemies of the U.S." Taylor asked Dep Assistant USTR Mowery to explain our trade package. After listening, Tuzmen said he appreciated this effort, but "frankly this is peanuts." He said GSP expansion was good (note: in fact it is on item 15 of the Turkish list), but the QIZ U.S. input condition needed to be changed. Turkey imports 400,000 metric tons of cotton fiber per year, and U.S. cotton should be the input condition "provided your price is right." Turkey has sufficient production of fabric and yarn, he said. In conclusion, he stressed "our southeast is bleeding" and among Turkey's needs was \$2 billion for the Turkish Ex-IM Bank (note: in his portfolio) which the U.S. should provide.

¶16. (C) Taylor thanked Tuzmen for his views and suggestions, and urged him to consider the trade package which the U.S. had designed to help Turkey. We believe it could lead to \$1 billion in trade expansion over a short period of time, a nearly 20 percent increase in bilateral trade. In a later meeting with Babacan, Taylor responded to the Turkish trade list. Many items on the list had to do with Turkey's future trade and investment relationship with Iraq, and implied that the U.S. would ensure preferential Turkish treatment. Taylor said we couldn't do this. Instead he stressed the Afghanistan reconstruction model - the U.S. would work to help ensure a level playing field, with the contracts going to the best bidders, and this would help Turkish firms. The USG would separately be active with Turkish firms in helping publicize opportunities in Iraq.

Term Sheet Next Steps

¶17. (C) Regarding our list of "technical/procedural questions" attached to the term sheet, the Turks answered:

-- The funds should be disbursed to a GOT account held by the Central Bank, acting as the GOT's agent, with the Federal Reserve Bank of New York. The GOT may set up a new sub-account of the existing account to hold the funds, as was done with the \$200 million in ESF disbursed in November 2002.

-- The Treasury Undersecretariat will be in charge of operational issues.

-- The GOT will not engage outside legal counsel. Instead it will rely on its in-house lawyers, and requests that the U.S. team return to Ankara to work with them.

-- Typically, a loan agreement doesn't require parliamentary approval. The GOT needs to examine whether this one will require such approval, given the references to military issues.

-- The Central Bank will play a role, as agent for the GOT in the NY Fed account.

¶18. (C) Embassy recommends Washington agencies consider the following two next steps:

-- Provide Ambassador with instructions to go back to the GOT on the economic MOU. These instructions should say whether the USG is willing to negotiate an economic MOU, and should include our description of the format of the documents we foresee signing to complete the economic assistance package.

-- U.S. Del should plan to return to Ankara by 2/12, with a view to finalizing the documents before the parliamentary vote on 2/18 in Ankara.

¶19. (C) U/S Taylor did not have the opportunity to clear this message before departing Ankara 2/8.

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